(10)

No. 95-1181

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

WILLIAM C. DUNN and DELTA CONSULTANTS, INC.,

Petitioners,

v.

COMMODITY FUTURES TRADING COMMISSION, et al.,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF THE CHICAGO MERCANTILE EXCHANGE AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

JERROLD E. SALZMAN
(Counsel of Record)
JAMES T. MALYSIAK
ALBERT F. ETTINGER
FREEMAN, FREEMAN
& SALZMAN, P.C.
401 North Michigan Avenue
Suite 3200
Chicago, Illinois 60611
(312) 222-5100

Counsel for the Chicago Mercantile Exchange

Midwest Law Printing Co., Chicago 60610, (312) 321-0220

33 pp

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Statutes

Regulations

Miscellaneous

BRIEF OF THE CHICAGO MERCANTILE EXCHANGE AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

Pursuant to this Court's Rule 37, the Chicago Mercantile Exchange ("CME") respectfully submits this brief with the consent of the parties.

STATEMENT OF INTEREST

The Commodity Exchange Act ("CEA") and the regulations of the Commodity Futures Trading Commission ("CFTC") provide that all commodity futures contracts and virtually all commodity options must be traded on "contract markets" approved by the CFTC (unless specifically exempted from such requirement). Exchange traded futures and options contracts are subject to the CFTC's exclusive regulatory jurisdiction. 7 U.S.C. §§ 2, 6(a) and (c), and 6c(b); 17 C.F.R. § 33.3. The CME has been designated by the CFTC as a "contract market" under the CEA. 7 U.S.C. §§ 7 and 8. The CME pioneered foreign currency futures and options trading in the early 1970s and is designated as a contract market for many currency futures and options.

Congress found futures and options trading to be "affected with a national public interest . . . rendering regulation of such transactions imperative for the protection of such commerce and the national public interest." 7 U.S.C. § 5. Petitioners ask this Court to hold that a minor provision of the CEA—the "Treasury Amendment"—vitiates Congress' regulatory scheme. Petitioners' position is that a dealer may avoid the CEA and CFTC regulation by trading in its back office rather than through a regulated market. Any entity, no matter how unscrupulous or under-capitalized, would be free to oper-

ate as a dealer in options contracts and offer those instruments to any customer without complying with any of the regulatory dictates of the CEA that Congress found "imperative." 7 U.S.C. § 5. Further, because options and futures are generally interchangeable as an economic matter, judicial acceptance of petitioners' position would directly affect both options and futures contract markets.

Adoption of petitioners' position also would foster an unprincipled competitive disadvantage for exchange markets that are subject to costly regulation and would judicially sanction unregulated off-exchange markets in options that would continue to drain volume and liquidity away from the exchanges. The CME therefore has a substantial interest in the Court's decision. Adoption of the position argued by petitioners would eliminate the current statutory mandate that futures and options be traded on CFTC-approved markets or subject to CFTC regulatory exemptions. The CME urges this Court to affirm the position taken by the Second Circuit which joined the Seventh Circuit in reading the Treasury Amendment in accordance with its plain meaning and the public interests Congress has found to be served by the CEA.

STATEMENT OF FACTS

Futures and Options: Background and Regulatory Regime.

Futures and options contracts are instruments that are traded by parties seeking to hedge the risk of future commodity price changes or to speculate on those future

price changes. On exchanges today, over 95% of futures and options trading is done by market professionals, commercial businesses and financial institutions—not the general public. Futures and options generally are not used to transfer title to or ownership of a commodity, and for many purposes futures and options trading are equally viable economic alternatives. *See Chicago Mercantile Exchange v. SEC*, 883 F.2d 537, 543 (7th Cir. 1989), *cert. denied*, 496 U.S. 936 (1990).

In a futures contract, the buyer (long) and seller (short) agree upon a price at which the future sale of a commodity will occur. In an option contract, the buyer (holder) and seller (writer) agree upon the price of the premium the buyer will pay to the seller for the right to buy or sell a commodity or a futures contract at a specified price on a specified date. In return for the premium, the option seller is obligated to sell or buy the commodity if the holder "exercises" his rights under the option.

As a practical matter, very few futures result in delivery and very few traded options result in delivery of a physical commodity. Instead, the parties to futures and options contracts typically offset their original contract to buy or sell a commodity at a future date, with a subsequent, corresponding sell or buy contract.

Early in this century, Congress considered banning futures trading and actually banned options trading for many years. *See* Stein, *The Exchange-Trading Requirement of the Commodity Exchange Act*, 41 Vand. L. Rev. 473, 477 (1988) ("Stein"); 7 U.S.C. §§ 6c(a)(B), 6c(c). Since futures and options provide hedging and price discovery benefits to the American economy, Congress has allowed futures and, over time, options to be traded, but only under the CEA and subject to exclusive CFTC jurisdic-

tion. 7 U.S.C. §§ 2 and 5. The CEA relies heavily on self-regulation by approved contract markets, 7 U.S.C. §§ 7 and 7a, subject to CFTC oversight. The CEA also prohibits fraud and manipulation, requires futures professionals to be registered, imposes limits on speculation, and contains many other regulatory safeguards. *See* 7 U.S.C. §§ 6a, 6b, 6d, 6e, 6f, 6k, 6m, 6o and 9.

Until 1992, Congress required all futures and virtually all options to be traded on CFTC-designated contract markets. 7 U.S.C. §§ 6(a), 6c(b) and 17 C.F.R. 33.3. In amending the CEA in 1992, Congress granted the CFTC the authority to exempt particular instruments from the contract market designation requirement provided that such an exemption was found to be in the public interest and consistent with the purposes of the CEA. *See* 7 U.S.C. § 6(c)(2). The CFTC has used that authority to exempt certain currency, interest rate and commodity swap agreements, and certain so-called "hybrid" transactions, from the contract market designation and most other CEA requirements. *See* 17 C.F.R. Parts 34, 35.

The 1974 CEA Amendments: Creating the CFTC and its Jurisdiction.

In 1974, Congress substantially strengthened the CEA. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 366 (1982). The 1974 amendments created the CFTC to exercise "exclusive jurisdiction" over futures and options under the CEA, thereby superseding any applicable jurisdiction of other federal agencies and preempting state regulation. 7 U.S.C. § 2; S. Rep. No. 1131, 93d Cong., 2d Sess. 19, 23 (1974).

The 1974 amendments also defined foreign currencies and government securities as commodities under the CEA and subjected futures and options involving those new "commodities" to the same regulatory structure as all other CEA-regulated commodities. *Id.* Congress recognized that unregulated currency futures were already being traded, yet expanded the "commodity" definition because it saw "no reason why a person trading in one of the currently unregulated futures markets should not receive the same protection afforded to those trading in the currently regulated markets." H.R. Rep. No. 975, 93d Cong., 2d Sess. 76 (1974). Congress knew that "markets in a number of foreign currencies" were among the "important futures markets" that were "completely unregulated by the Federal Government." S. Rep. No. 1131, at 19. Congress enacted the 1974 CEA Amendments "to fill all regulatory gaps—to regulate trading in futures and in options . . . because such trading is now poorly regulated, if it is regulated at all." 120 Cong. Rec. 34,736 (Oct. 9, 1974) (Remarks of House Conference Committee Chairman Poage); 120 Cong. Rec. 34,997 (Oct. 10, 1974) (Remarks of Senate Conference Committee Chairman Talmadge).

Statutory Exclusions from the CEA.

Since its inception, the CEA generally has had only limited application to contracts that result in immediate delivery of a commodity (cash or spot transactions) or to so-called forward contracts designed to allow commercial enterprises to transfer actual ownership of a commodity in the future. Forward contracts are carved out of the CEA's description of a futures contract ("contract for the purchase or sale of a commodity for future delivery," 7 U.S.C. § 6(a)) by a provision that states: "The term

'future delivery,' as used in this Chapter, shall not include any sale of any cash commodity for deferred shipment or delivery." 7 U.S.C. § 2.

When enacted in 1922, the forward contract provision was designed to apply to common commercial transactions in the agricultural commodities that were then the only commodities covered by the statute. Thus, the provision excluded contracts whereby a "farmer [would] sell part of next season's harvest at a set price to a grain elevator or miller." *CFTC v. Co Petro Marketing Group, Inc.*, 680 F.2d 573, 577 (9th Cir. 1982) (footnote omitted). Unlike futures, where offset is routine, "both parties to the [forward] contracts deal in and contemplate future delivery of the *actual* [commodity]." 680 F.2d at 578 (emphasis in original).

In the 1974 amendments to the CEA, Congress enacted a corollary exclusion—the Treasury Amendment. During the pendency of that legislation, the Treasury Department expressed concerns relating to the CFTC's jurisdiction over transactions in certain financial instruments—including currency and government securities—that became commodities under the expanded "commodity" definition in the pending bill. S. Rep. No. 1131, at 49-51. To address that concern, Congress provided (7 U.S.C. § 2) that:

> Nothing in this chapter [7 U.S.C. § 1, *et seq.*] shall be deemed to govern or in any way be applicable to transactions in foreign currency, security warrants, security rights, resales of installment loan contracts, repurchase options, government securities, or mortgages and mortgage purchase commitments, unless such transactions involve the sale thereof for future delivery conducted on a board of trade.

SUMMARY OF ARGUMENT

In effect, petitioners argue that in enacting the Treasury Amendment Congress wrecked the comprehensive regulatory framework it was constructing through the rest of the 1974 CEA Amendments by excusing options in foreign currency and other important instruments from the CEA's safeguards and regulatory costs. The plain language of the Treasury Amendment and the history of the 1974 CEA Amendments refute this argument.

The Court below and the Seventh Circuit have ruled that since the Treasury Amendment's exclusionary phrase encompasses only actual "transactions in" the listed commodities (7 U.S.C. § 2), it does not exclude from CEA coverage options which are derivative transactions designed for hedging or trading, rather than actual ownership of, for example, currency. This straightforward reading of the statutory language is also sound policy because interpreting the Treasury Amendment's statutory exclusion narrowly—especially given the fact that the CFTC's broad exemptive powers has allowed the CFTC to address the legitimate concerns regarding unnecessary regulation voiced by banks and certain other market participants—is preferable to judicially undermining the CEA's basic framework. Excluding all over-the-counter options trading in major commodities like currency and government securities from the CEA would be a major departure from the seventy-year history of the CEA.

Petitioners and the *amici* who have supported petitioners correctly state that the CEA should treat foreign currency options in the same manner as foreign currency futures. However, implicitly contradicting themselves, petitioners' argument actually entails that futures con-

tracts for foreign currency and the other instruments covered in the Treasury Amendment are subject to the CEA but options contracts for these commodities are completely outside the CEA's protections. As a matter of proper statutory interpretation and sound regulatory policy, the CEA should be held to regulate transactions in *both* options and futures contracts for foreign currency and the other instruments listed in the Treasury Amendment. Moreover, there is nothing unworkable or unreasonable about the Second Circuit's interpretation of the Treasury Amendment's treatment of foreign currency options.

Still further, Congress' implicit adoption in the 1982 and 1992 Amendments to the CEA of the Second and Seventh Circuits' holding that transactions in options are not "transactions in" the underlying commodities provides further grounds for affirming the Second Circuit in this case.

Finally, the Court should reject the holdings of *Salomon Forex, Inc. v. Tauber*, 8 F.3d 966 (4th Cir. 1993), *cert. denied*, ___ U.S. ___, 114 S.Ct. 1540 (1994), and reject an interpretation of the Treasury Amendment that would subject foreign currency futures and options to CEA regulation only if the transactions were entered into by small or unsophisticated investors. Even aside from the unworkability of making CEA jurisdiction depend on the sophistication of the transacting parties, there is no basis in the CEA for drawing such a distinction.

ARGUMENT

One must begin with the language of the statute. *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241 (1989). Petitioners agree, but actually seek to rewrite the statute by focusing exclusively on the word "transactions" while ignoring the preposition "in" that modifies "transactions."

In the CEA, Congress did not employ the phrase "transactions in" a commodity to describe futures or options contracts; instead that phrase was designed literally to mean cash and forward contracts where delivery and therefore an actual transaction in the commodity is contemplated.

I. FUTURES AND OPTIONS ARE NOT "TRANSACTIONS IN" COMMODITIES.

The Treasury Amendment's key phrase limits its coverage to "transactions in" foreign currencies and the other listed instruments. The plain meaning of "transactions in" compels affirmance of the Second Circuit's decision. In common language one would not say that one had engaged in a currency transaction if one bought or sold the right to enter into a transaction. *Cf. Lavanthall v. General Dynamics Corp.*, 704 F.2d 407, 412 (8th Cir.), *cert. denied*, 464 U.S. 846 (1983) (under securities laws, purchases of stock options have no "transactional nexus" with underlying stocks). Certainly no one can deny that a word used in a statute must be construed in context and that prepositions and adjectives may change the meaning of a word or phrase used in a statute. *See Gustafson v. Alloyd Co.*, 513 U.S. ___, 115 S.Ct. 1061, 1069 (1995) ("a word is known by the company it keeps").

The Second and Seventh Circuits have held that, when read literally, the Treasury Amendment excludes only actual "transactions in" the enumerated commodities (here, foreign currency), not options and futures. *See CFTC v. American Board of Trade, Inc.*, 803 F.2d 1242 (2d Cir. 1986); *Board of Trade v. SEC*, 677 F.2d 1137 (7th Cir.), *vacated as moot*, 459 U.S. 1026 (1982). The Second Circuit concluded in *American Board of Trade*, 803 F.2d at 1248, that:

> an option to buy or sell foreign currency is not a purchase or sale of the currency itself and hence is not a transaction "in" that currency, but at most is one that relates to the currency.

This reasoning was adhered to in the decision below:

> Our reasoning [in *American Board of Trade*] was that an option was simply the right to engage in a transaction in the future, and, until this right matured, there was no exempt "transaction." The exercise of an option would constitute a "transaction in foreign currency," but the purchase or sale of the option itself would not be such a "transaction" under the Treasury Amendment. *CFTC v. Dunn*, 58 F.3d 50, 53 (2d Cir. 1995).

The Seventh Circuit reasoned similarly in *Board of Trade v. SEC*, 677 F.2d at 1154 in holding that the Treasury Amendment does not apply to the trading of government securities options:

> "The option transaction is a long step removed from a transaction in the commodity involved, since the option purchaser, if he or she does nothing more when the specified date arrives, will simply see the option die." *Commodity Futures Trading Commission v. American Board of Trade*, 473 F.Supp. 1177, 1183 (S.D.N.Y. 1979); see also *Commodity Futures Trading Commission & State of Georgia v. Sterling Capital Co.* [[1980-1982 Transfer Binder] Comm. F. L. Rep. (CCH) ¶ 21,169 at 24,783-24,784 (N.D. Ga.), *modified*, ¶ 21,170 (N.D. Ga. 1981).] Only when the option holder exercises the option is there a transaction in a government security.[1]

The distinction between transactions "in" commodities and derivative transactions that "involve" commodities goes to the heart of the CEA. Congress did not intend the CEA's entire regulatory scheme to apply to actual transactions in commodities—that is, transactions where title or ownership is transferred or is expected to be transferred. Rather, the CEA primarily regulates derivative transactions (futures and options) that involve commodities where the parties do not expect to and routinely do not transfer title to or ownership of the commodity. Futures and options are traded in order to hedge or speculate in future price changes in a commodity without the cost and expense of acquiring a commodity through transactions "in" the commodity.

---

[1] The Seventh Circuit subsequently confirmed that, as with options contracts, "[t]rading [of futures contracts] occurs in 'the contract', not in the commodity." *Chicago Mercantile Exchange v. SEC*, 883 F.2d at 542. *See also Abrams v. Oppenheimer Gov't Sec., Inc.*, 737 F.2d 582, 589-593 (7th Cir. 1984), (GNMA forward contracts that typically resulted in delivery excluded from the CEA by Treasury Amendment); *Bank Brussels Lambert, S.A. v. Intermetals Corp.*, 779 F. Supp. 741, 748-750 (S.D.N.Y. 1991) (cash market currency transactions excluded from CEA by Treasury Amendment); *CFTC v. Standard Forex, Inc.*, [1992-1994 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 26,063 (E.D.N.Y. 1993) (foreign currency futures contracts not excluded from CEA by Treasury Amendment).

The Treasury Amendment itself evidences congressional appreciation and endorsement of that distinction. That provision excludes actual "transactions in" the listed commodities, while including within the CEA's purview derivative "transactions involv[ing]" those commodities for future delivery conducted on a board of trade. 7 U.S.C. § 2.

The Treasury Amendment's exclusion should be limited to cash and forward contracts in the listed commodities as the Second and Seventh Circuits have held. The Treasury Amendment was enacted by Congress only to assure the Treasury Department that the CFTC would not regulate spot and forward contracts in the instruments listed in the Amendment unless those transactions actually involved trading on a board of trade.

II. THE HISTORY, PURPOSE AND STRUCTURE OF THE CEA AND THE 1974 AMENDMENTS SUPPORT THE VIEW THAT THE TREASURY AMENDMENT DOES NOT EXCLUDE OPTIONS.

While the statutory language of the Treasury Amendment supplies more than adequate reason to affirm, the history and structure of the CEA also support affirmance.

First, the Treasury Department's much-cited letter to the Senate Committee in 1974 nowhere mentioned foreign currency options or any other options except repurchase options. Indeed, although the Treasury Department's letter referred loosely to the need to exempt "futures" in the listed commodities from the CEA and this terminology was used by the Senate Committee in paraphrasing the Treasury Department's letter, the key

congressional reports do not suggest that options or futures are among the excluded transactions. *See* S. Rep. No. 1131, 93d Cong., 2d Sess. 23 at 49-51.[2] Thus, the legislative history of the Treasury Amendment does not provide any evidence of congressional intent to exclude any options or futures contracts from the CEA.

Second, petitioners' reading of the Treasury Amendment conflicts with Congress' expressed intention in 1974 to fill all regulatory gaps in the marketing of options contracts and to subject previously unregulated options contracts to exclusive CFTC jurisdiction. Surely if Congress intended the Treasury Amendment to create new, large gaps in the CFTC's jurisdiction and leave whole categories of options contracts unregulated, Congress would have made that intent explicit. The congressional policy underlying the 1974 expansion of the CEA requires that options contracts not be excluded from that statute's coverage.

---

[2] The Treasury Department's letter shows no awareness of the difference between futures and forwards and is thus consistent with an intent to exclude only spot and forward transactions from the CEA. Further, given the Treasury Department's use in the "unless" clause of the extremely broad, statutory-defined term "board of trade" in drafting the exclusion from the Treasury Amendment, it is impossible to determine what specific types of transactions the Treasury Department wanted to exclude from the CEA.

In any event, the issue here is not what the Treasury Department intended, but what Congress intended. The language adopted and the legislative history of the 1974 Amendments to the CEA demonstrate that Congress only intended to exclude spot and forward contracts.

Finally, as a general matter of statutory construction, statutory exceptions are to be strictly construed so that the exception does not swallow the rule. *See A.H. Phillips, Inc. v. Walling*, 324 U.S. 490, 493 (1945). Petitioners would read the Treasury Amendment's exclusion to scrap the CEA's regulatory scheme for trading in the listed commodities thereby creating an unwarranted vacuum in statutory coverage and regulatory policy. That result would destroy the core of the CEA, at least for such important commodities as foreign currencies and government securities. Under petitioners' view of the CEA, con artists operating "bucket shops" would obtain a "safe harbor" for offering fraudulent off-exchange products in Treasury Amendment commodities without any fear that their misconduct would violate the CEA.[3]

Adoption of petitioners' argument also would defeat the CEA's emphasis on exchange self-regulation. *See* 7 U.S.C. §§ 7, 7a and 8 (requiring exchanges to police for price manipulation and to enforce their rules). It would also mean:

---

[3] Congress required trading of options and futures on CFTC-designated contract markets in order to eliminate bucket shops, which were businesses that purveyed non-exchange traded futures contracts to investors through various forms of fraud and deceit. *See, e.g.*, 61 Cong. Rec. 1,318 (1921) (Remarks of Rep. Voight) (stating that "[t]he bucket shop is wiped out in this bill"); 132 Cong. Rec. S17,023 (Oct. 17, 1986) (Remarks of Sen. Melcher) (stating that the "mayhem" of bucket shops caused Congress to require all lawful futures to be traded on federally approved exchanges). *See also* Stein, 41 Vand. L. Rev. at 481-482.

- no antifraud rules, 7 U.S.C. § 6b; 17 C.F.R. 33.10;
- no record-keeping or audit trail requirements, 17 C.F.R. 1.35;
- no trade practice rules, 17 C.F.R. 1.38, 1.39, Part 155;
- no ban on manipulation, 7 U.S.C. §§ 7(d), 9;
- no CFTC registration requirements, 7 U.S.C. § 6d; 17 C.F.R. Part 3.

In short, adoption of petitioners' position would preclude all forms of CEA trading regulation for non-exchange options trading in the listed commodities.

III. PETITIONERS ARE CORRECT THAT OPTIONS AND FUTURES SHOULD BE TREATED SIMILARLY UNDER THE CEA BUT THAT REQUIRES HOLDING THAT THE CEA COVERS OFF-EXCHANGE FOREIGN CURRENCY OPTIONS.

Petitioners (Pet. Br. 14) and all their supporting *amici* admit that options contracts and futures contracts are very similar both in form and purpose and must be treated in a similar manner by the CEA. However, the construction of the Treasury Amendment advanced by petitioners and one of the two groups of *amici* in fact would mandate a sharp distinction in the CEA's coverage of options and futures involving the commodities listed in the Amendment. The other group of *amici* takes a position which is inconsistent with petitioners' in an unsuccessful effort to escape the self-contradiction petitioners' position entails.

Petitioners and *amici* Credit Lyonnais, Bank Julius Baer & Co. Ltd., Chase Manhattan Bank, N.A. and Societe General argue that options on foreign currencies

are outside the coverage of the CEA. But this means that options on foreign currencies would be treated entirely differently from futures on foreign currencies. Futures are generally covered by the CEA no matter how "transactions in" is interpreted because of the Treasury Amendment's "unless" clause. The "unless" clause undeniably excludes from the exclusion any transaction which involves the sale of a futures contract on a "board of trade." "Board of trade" is very broadly defined in the CEA as "any exchange or association . . . of persons who shall be engaged in the business of buying or selling commodity. . . ." 7 U.S.C. § 1a(1). Thus, it is clear that if petitioners had been selling foreign currency futures their activities would have been covered by the CEA.[4] By arguing that they should escape CEA coverage, petitioners are claiming the CEA treats foreign currency options differently from foreign currency futures.

Amici Foreign Currency Exchange Committee, New York Clearing House Association, Futures Industry Association, Managed Funds Association, and Public Securities Association apparently recognize that they cannot without self-contradiction claim both that options and futures are treated similarly by the CEA and that options on foreign currency are outside the CEA given that futures on foreign currency are certainly covered by the CEA if they are traded on a "board of trade." These trade association *amici* attempt to avoid their dilemma by claiming that both options and futures in the listed commodities fall under the Treasury Amendment and that both options and futures are subject to the "unless" clause (Foreign Exchange Committee et al. Brief at 22 n. 18). Consistent with this position, the trade association *amici* ask the Court to remand to the district court for a determination of whether petitioners' conduct involved transactions on a "board of trade."

[4] In *CFTC v. Co Petro Marketing Group Inc.*, 680 F.2d 573, 581 (9th Cir. 1982), it was held that "board of trade" as defined by the CEA was broad enough to include a corporation that was trading gasoline futures in an unregulated market. The CFTC has consistently taken the same broad approach in applying the definition of "board of trade." It has held that a sole proprietor operating a bucket shop could be a board of trade. *In re Stovall*, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,941 at 23,781 (CFTC 1979). *See also CFTC v. National Coal Exchange, Inc.*, [1980-1982 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 21,424 at 26,053 (W.D. Tenn. 1982) (company operated "as a kind of board of trade"); CFTC Interpretive Letter No. 77-12, [1977-1980 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 20,467 at 21,911-912 (Aug. 17, 1977) (government securities dealers may be a board of trade).

However, the "unless" clause simply does not mention options, and the trade association *amici*'s attempt to make it cover options has no basis in the text of the Treasury Amendment or the CEA. Moreover, adoption by the Court of the position taken by the trade association *amici* would not help petitioners or *amici*. It is clear that, given the very broad statutory definition of "board of trade," the activities of both petitioners and *amici* are subject to the CEA if options contracts are subject to the "unless" clause.

In fact, to reach the (correct) result that the CEA treats options contracts the same as futures contracts, it is necessary to hold that options transactions are not "transactions in" the underlying commodity. The Treasury Amendment excludes CEA coverage of contracts contemplating actual delivery of the underlying commodities but does not exclude coverage of either futures con-

tracts or options contracts. This is entirely consistent with the statutory language.

Finally, the argument made by petitioners that the Second Circuit's treatment of CEA jurisdiction over options is unreasonable or unworkable (Pet. Br. 14-15) is totally without merit. The Second Circuit's holding that foreign currency option contracts are subject to CEA jurisdiction does not require anyone to guess at the time of entering the option contract whether the option will be exercised to determine whether the option is subject to CEA jurisdiction. Under the CEA and the ruling by the Court below, option contracts on commodities are always subject to CEA jurisdiction whether they are ultimately exercised or not. In the exceptional case, in which the option is exercised, the exercise of the option would not retroactively remove CEA jurisdiction over the option contract.[5]

IV. THE 1982 AND 1992 AMENDMENTS TO THE CEA SUPPORT CEA COVERAGE OF FOREIGN CURRENCY FUTURES AND OPTIONS.

It is evidence that a statutory interpretation is correct that the interpretation has been brought to the attention of Congress and Congress has not sought to alter it while amending the statute in other respects. *See Atkins v. Rivera*, 477 U.S. 154, 166 n.10 (1986); *North Haven Board of Education v. Bell*, 456 U.S. 512, 535 (1982);

[5] The treatment by the Court below of option contracts under the CEA is identical to the established treatment of futures. Futures contracts are subject to the CEA at the time they are made whether or not delivery is subsequently made under the contract.

Zipes v. Trans World Airlines, Inc., 455 U.S. 385, 394-95 (1982). Congress has twice considered practical problems allegedly created by narrow interpretations of the Treasury Amendment which resulted in broad CEA coverage of futures and options. In both cases, Congress carefully amended the law to address the problems that it found actually existed without amending the Treasury Amendment to exempt off-exchange options trading.

In 1982, legislation was enacted in response to the holding of *Board of Trade v. SEC*, 677 F.2d 1137, that the Treasury Amendment did not apply to options but only to transactions in the underlying commodities. Although it was dissatisfied with some of the practical results of the Seventh Circuit's holding, Congress did not tamper with the Seventh Circuit's interpretation of the Treasury Amendment. H. Rep. No. 97-626, 97th Cong., 2d Sess., Part I at 7-8. Instead Congress excluded from the CEA options on government securities (7 U.S.C. § 2a(i)) and options on foreign currencies if traded on a national securities exchange (7 U.S.C. § 6c(f)). The legislative history of the 1982 Amendments shows that Congress recognized that this would allow the CFTC to continue to regulate foreign currency options traded on commodities markets. H. Rep. No. 97-626, 97th Cong., 2d Sess., Part II at 12. Given the unaltered Seventh Circuit holding on the meaning of the Treasury Amendment, off-exchange foreign-currency options also remained subject to the CEA and CFTC regulation.

In 1992, in granting the CFTC authority to exempt specific instruments from the exchange-trading requirement, 7 U.S.C. § 6(c), Congress plainly acted with the understanding that prior to that amendment all futures contracts and almost all options were required to be

traded on CFTC-designated contract markets. If the Treasury Amendment had removed broad categories of options and futures products from the CEA and CFTC jurisdiction, Congress in 1992 would have cited that exclusion in determining whether the exchange-trading requirement was too rigid. Instead, the legislative history of the 1992 amendment to the exchange-trading requirement demonstrates the exact opposite. The 1992 amendment was designed to allow the CFTC to address in a careful and limited fashion some of the concerns of banks and other market participants which petitioners claim Congress addressed in a blunderbuss fashion with the Treasury Amendment. *See* S. Rep. No. 102-22, 102d Cong., 2d Sess. 17, 59-62 (1992); H.R. Conf. Rep. No. 102-978, 102d Cong., 2d Sess. 76-83 (1992).

The 1992 amendment also eliminated any basis for genuine concern that, absent a broad construction of the Treasury Amendment, the 1974 expansion of the CEA and CFTC jurisdiction could disrupt markets for foreign currency and other financial instruments already regulated by other federal agencies. To the extent that such markets actually involve the trading of options or futures contracts rather than only spot and forward contracts, the CFTC now has the power to exempt a market from any or all CEA regulation and even limit that exemption to those instruments that are subject to regulation by other federal agencies. In fact, in its hybrid exemption (17 C.F.R. Part 34), the CFTC only exempted those instruments that would be subject to regulation under federal securities or banking laws.

In sum, through its 1992 grant of exemptive authority to the CFTC, Congress established a specific mechanism that allows the CFTC to determine what level of regulation, if any, is appropriate for non-exchange futures trading. Adoption of petitioners' position would strip the CFTC of that power for foreign currency and government security options. That result is out of step with Congress' recent actions and should be rejected.

V. THE FOURTH CIRCUIT ERRED BY HOLDING IN *SALOMON FOREX* THAT THE TREASURY AMENDMENT EXCLUDES CATEGORIES OF TRADERS FROM THE CEA.

The Fourth Circuit in *Salomon Forex* erred in holding that options and futures contracts on foreign currency and other commodities mentioned in the Treasury Amendment are excluded from CEA coverage. *Salomon Forex* did not help matters by attempting to fix the huge regulatory hole its holding implied by suggesting that the CEA would still somehow protect small unsophisticated investors in foreign currency options when the language of the Treasury Amendment supplies no basis for *Salomon Forex*'s distinction in coverage between the sophisticated and novices.

In *Salomon Forex* the Fourth Circuit reasoned that because futures are mentioned in the "unless" clause that they must be covered by the Treasury Amendment and, because options are economically similar to futures, options too should be excluded for the CEA.[6] *Salomon*

---

[6] The Fourth Circuit's reasoning based on the "unless" clause is flawed. Transactions in foreign currency (*i.e.*, cash and forward transactions) that are complex can involve a futures transaction and thereby be covered by the "unless" clause. The "unless" clause, then, excludes a subset of cash and forward transactions from the Treasury Amendment.

(continued...)

Forex was emphatic that there is "no principled reason" to distinguish between foreign currency options and futures. 8 F.3d at 974-76. The Fourth Circuit apparently overlooked the fact that the "unless" clause dictates that futures contracts in the commodities listed in the Treasury Amendment are generally covered by the CEA. Thus, if there is "no principled reason" to distinguish foreign currency options and futures, options should also be covered by the CEA.

---

[6] (...continued)

The Fourth Circuit also believed that the Treasury Amendment was not limited in its reach to spot and forward contracts because that would cause it to be unnecessary in that it would overlap in part with the forward or "cash commodity" exclusion provided at 7 U.S.C. § 2. 8 F.3d at 975. But the 1922 enactment of the forward exclusion greatly predates that of the Treasury Amendment. Congress frequently passes provisions which are redundant of earlier enacted statutes, *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 253 (1992) ("redundancies across statutes are not unusual events in drafting"), and it is hardly surprising that the Treasury Amendment was enacted even if it was somewhat unnecessary. The Treasury Department may well have not been aware that its concerns were unjustified given the forward exclusion. *See* Stein, 41 Vand. L. Rev. at 493. Further, it is not unusual for Congress to enact statutory provisions to prevent the courts from holding that an activity is covered by a law even when there is no particular reason to believe the courts will so interpret the law. For example, in the Soft Drink Interbrand Competition Act, 15 U.S.C. § 3501 *et seq.*, Congress precluded the courts from construing the Sherman Act to hold vertical territorial restraints in soft drink distribution *per se* illegal although this Court had held that vertical territorial restraints are not *per se* illegal in *Continental T.V. Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977), before the Soft Drink Act was enacted. *See also* 15 U.S.C. § 4302.

Further, *Salomon Forex* overemphasized the vague language of the Treasury Department letter to the point of discarding the expressed will of Congress in the statute itself. Admittedly the legislative history of the Treasury Amendment reflects considerable confusion on the part of the Treasury Department.[7] However, the text of the Treasury Amendment, the text of the CEA generally, and the clear goals stated by Congress in passing the 1974 CEA Amendments all support holding that the Treasury Amendment excludes spot and forward contracts from CEA coverage unless the spot and forward contracts are involved in a futures transaction on a board of trade.

Salomon Forex was wrong to hold that the CEA does not cover foreign currency futures and options but also was wrong to attempt an *ad hoc* solution to some of the problems its holding created. The language of the Treasury Amendment makes no distinctions based upon the knowledge, financial sophistication, or other traits of the persons entering into the contracts in question.

Moreover, *Salomon Forex*'s approach to CEA coverage would require case-by-case judicial findings concerning the knowledge and sophistication of the participants in a transaction to determine whether the Treasury Amendment applies. It would also lead to the anomaly of otherwise identical transactions being subject to disparate regulatory treatment depending upon the identity of some of the counterparties. For instance, currency contracts sold by a dealer to certain importers could be excluded

---

[7] This confusion undoubtedly resulted in part from the regulatory revolution that the 1974 CEA Amendments caused by expanding from traditional agricultural commodities to the new financial futures.

from the CEA, while identical contracts sold by the same dealer to other importers would be subject to the CEA. That kind of legislative line-drawing may be appropriate in the context of the CFTC's exemptive powers, which are regulations of general applicability where agency specificity may lessen legal uncertainty. But trying to read a fact-specific legal test into a statutory provision that never even mentions the identity of the parties to excluded transactions would be a recipe for heightened legal uncertainty that could curtail legitimate business transactions.[8] The approach adopted by the Fourth Circuit must be rejected as unprincipled and unworkable.

The Fourth Circuit's decision in *Salomon Forex* was influenced by the fears expressed by banks and others that a narrow interpretation of the Treasury Amendment threatened to undermine multibillion-dollar world-wide currency markets. 8 F.3d at 976. That Court was told that if the full scope of CFTC regulation was applied to those markets (the feared outcome of a narrow construction), U.S. banks and institutions would not be able to participate in those important currency markets. No one supports that result, but there is no reason to fear that

---

[8] Some courts and commentators have suggested that the Treasury Amendment excludes only "otherwise regulated" futures and options, but that reading is unsupportable and unworkable. Nothing in the Treasury Amendment's language suggests that Congress contemplated excluding "otherwise regulated" futures and options from the CEA. Moreover, asking market participants and, ultimately, courts to determine whether various transactions are subject to various unknown statutes, both state and federal, and then determining whether those laws constitute sufficient regulation to make a transaction eligible for exclusion from the CEA would be a daunting and largely counter-productive task.

result given the 1992 amendment. If any transactions need to be carved out of any aspect of the CEA's regulatory structure, this Court should allow the CFTC to apply its exemptive scalpel to those transactions rather than adopt a meat-axe approach.

CONCLUSION

Adoption by the Court of petitioners' interpretation of the Treasury Amendment would have the potentially catastrophic result of allowing traders in over-the-counter options involving foreign currencies and the other instruments listed in the Treasury Amendment to avoid *all* regulation. This result is the opposite of what Congress sought to accomplish in 1974 when it extended the scope of the CEA and the jurisdiction of the CFTC.

Therefore, the Chicago Mercantile Exchange asks the Court to affirm the decision below.

Respectfully submitted,

JERROLD E. SALZMAN
(Counsel of Record)
JAMES T. MALYSIAK
ALBERT F. ETTINGER
FREEMAN, FREEMAN
& SALZMAN, P.C.
401 North Michigan Avenue
Suite 3200
Chicago, Illinois 60611
(312) 222-5100

Counsel for the
Chicago Mercantile Exchange

Dated: August 30, 1996